Canadian Pacific Limited

Annual Report 1978

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*F. S. Burbidge, *President,* Canadian Pacific Limited, Montreal

*Keith Campbell, *Vice-President,* Canadian Pacific Limited, Montreal

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Allard Jiskoot, *Chairman of the Board of Managing Directors,* Pierson, Heldring & Pierson N. V., Amsterdam, The Netherlands

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*W. Earle McLaughlin, *Chairman of the Board,* The Royal Bank of Canada, Montreal

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The Rt. Hon. Lord Polwarth, T.D., D.L., *Director,* Bank of Scotland, Edinburgh, Scotland

*†Claude Pratte, Q.C., *Advocate,* Quebec

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A. M. Runciman, *President,* United Grain Growers Limited, Winnipeg

Thomas G. Rust, *President and Chief Operating Officer,* Crown Zellerbach Canada Limited, Vancouver

F. H. Sherman, *President and Chief Executive Officer,* Dominion Foundries and Steel, Limited, Hamilton

*Ian D. Sinclair, *Chairman and Chief Executive Officer,* Canadian Pacific Limited, Montreal

The Hon. John N. Turner, P.C., Q.C., *Partner,* Law Firm of McMillan, Binch, Toronto

†Kenneth A. White, *Chairman, President and Chief Executive Officer,* Royal Trustco Limited, Ottawa

*Ray D. Wolfe, *Chairman of the Board and President,* The Oshawa Group Limited, Toronto

*Member of the Executive Committee
†Member of the Audit Committee

Officers

Ian D. Sinclair, *Chairman and Chief Executive Officer,* Montreal

F. S. Burbidge, *President,* Montreal

Keith Campbell, *Vice-President,* Montreal

Corporate Services

J. C. Ames, *Vice-President and Secretary,* Montreal

Donald S. Maxwell, Q.C., *Vice-President Law and General Counsel,* Montreal

J. A. McDonald, *Vice-President Corporate Development,* Montreal

Paul A. Nepveu, *Vice-President Finance and Accounting,* Montreal

R. T. Riley, *Vice-President Administration,* Montreal

J. D. Kenny, *Comptroller,* Montreal

D. E. Sloan, *Treasurer,* Toronto

1979 Annual General Meeting

The Annual General Meeting of the Shareholders is to be held on Wednesday, May 2nd, 1979, at Le Château Champlain, Place du Canada, Montreal, at eleven a.m. (daylight saving time, if operative).

Contents

Stock Transfer Agents

The Royal Trust Company,
1648 Hollis Street, Halifax, N.S. B3J 1V7;

Brunswick House,
1 King Street, Saint John, N.B. E2L 1G1;

630 Dorchester Boulevard West,
Montreal, P.Q. H3B 1S6;

Royal Trust Tower, Toronto-Dominion Centre, Toronto, Ontario M5W 1P9;

287 Broadway,
Winnipeg, Manitoba R3C 0R9;

1862 Hamilton Street,
Regina, Saskatchewan S4P 2B8;

700 The Dome Tower, Toronto-Dominion Square, 333 - 7th Avenue S.W.,
Calgary, Alberta T2P 2Z1;

Royal Trust Tower, Bentall Centre,
555 Burrard Street,
Vancouver, B.C. V7X 1K2.

Bank of Montreal Trust Company,
2 Wall Street, New York, New York 10005

Deputy Secretary,
50 Finsbury Square,
London EC2A 1DD, England

Stock Holdings

The number of registered holdings of the voting capital stock of the Company at December 31, 1978 was 67,787.

The distribution by countries of total voting rights of the Ordinary and Preference Stock at that date was as follows:

Canada	72.07%
United States	13.67
United Kingdom	6.86
Other Countries	7.40
	100.00%

Stock Listings

Debenture Stock (Sterling) listed on:
London Stock Exchange

Debenture Stock (U.S. Currency) listed on:
New York Stock Exchange

Preference Stock (Sterling) listed on:
Montreal, Toronto, Vancouver and London, Eng. Stock Exchanges

Preference Stock (Canadian Dollar) listed on:
Montreal, Toronto, Vancouver and London, Eng. Stock Exchanges

Preferred Shares, Series A listed on:
Montreal, Toronto, Vancouver and London, Eng. Stock Exchanges

Ordinary Stock listed on:
Montreal, Toronto, Vancouver, New York and London, Eng. Stock Exchanges

Shareholders having inquiries should write to:

J. C. Ames,
Vice-President and Secretary,
Canadian Pacific Limited,
P.O. Box 6042, Station A,
Montreal, Canada
H3C 3E4

Si vous désirez vous procurer la version française du présent rapport, veuillez vous adresser au vice-président et secrétaire, Canadien Pacifique Limitée, C.P. 6042, succursale A, Montréal, Canada H3C 3E4

To the Shareholders

The past year was the best in the Company's history. Consolidated net income reached $340.9 million, an increase of $93.9 million over 1977. Per Ordinary share, earnings amounted to $4.72, or $1.31 more than in the previous year.

Dividends on the Ordinary stock were raised to $1.10, from 95¢ in 1977. Of the 1978 dividends, 55.5¢ was the proceeds of dividends from Canadian Pacific Investments Limited, up 7¢ over 1977.

Almost every operation of the Company shared in the earnings growth, with CP Investments and transportation each providing approximately half of the increase over 1977. Income from CP Investments reflected that company's net gain of $23.8 million on the sale of its holding of TransCanada PipeLines shares. In addition, earnings from iron and steel, oil and gas and forest products were all up substantially, and most other major operations contributed to the year's improvement. The notable exception was hotels, whose losses increased. In transportation, airline operations provided the largest increase, rail earnings in both Canada and the U.S. were at record levels, and the loss on tanker/bulk shipping operations was reduced. Miscellaneous income rose due to increased interest income and a gain on sale of an aircraft formerly leased to CP Air.

During the year CP Investments further broadened its earnings base through acquisition of Syracuse China Corporation of Syracuse, New York. Syracuse manufactures and markets chinaware and related products mainly for the food service industry in the United States and in Canada.

In a judgment in legal proceedings taken in the Supreme Court of Ontario against the Company by certain minority shareholders of the Ontario and Quebec Railway Company, the plaintiffs' actions succeeded in part. The Company has appealed the judgment but is of the opinion that even if upheld on appeal, the judgment will not have a materially adverse effect on the financial condition of the Company. Appeals by the plaintiffs are also anticipated.

For 1979, planned capital spending of the Canadian Pacific group of companies exceeds $1 billion for the first time. The amount is so high partly because of inflation, but mainly because of the growth the Company has achieved and the strong commitment it has to future growth. Projects comprising this large investment program include the creation of new capacity as well as replacement of the old. All are being undertaken with a view to strengthening the earning power of the subsidiaries and the parent company. Beneficial effects of the program will be widely felt throughout the economy as jobs are generated or sustained — both immediately and in the future — in many regions of the country.

The outlook for earnings in 1979 is that they will be at about the same level as in 1978. Given reasonable economic growth in the Canadian and U.S. economies, earnings from operations could increase enough to make up for the likely absence of a gain equivalent to that in 1978 from the sale by CPI of its TransCanada PipeLines shares. Changes — either upward or downward — in the value of the Canadian dollar would have an impact on the year's results. The outcome of labour negotiations could also have an important influence; the list of operations affected, although shorter than it was last year, includes such a key sector as the railway. A settlement with the railway unions, which now appears within reach, would remove a major uncertainty. Most of the signs with respect to commodities are positive. Prices for lead, zinc, gold and silver have strengthened. Demand for zinc has improved and markets continue to be favorable for newsprint, lead, steel and lumber. The only likely problem area is coking coal, which has been in excess supply for several years. Further expansion of real estate activiites should contribute to improved earnings. In transportation, CP Air should have a good year, but not as good as 1978, when circumstances were unusually favorable. Prospects for CP Ships are more encouraging than they have been for some time, but no dramatic turnaround should be expected in 1979. CP Rail will benefit from further growth in freight revenues and from being relieved of losses previously borne in respect of inter-city passenger services. Soo Line Railroad should match its excellent 1978 performance.

The Directors wish to acknowledge their appreciation of the support of customers and the contribution of officers and employees, which made 1978 such a successful year.

For the Directors,

President

Chairman and Chief Executive Officer

Montreal, March 12, 1979

Summarized Statement of Income of Canadian Pacific Limited

	1978	1977	Increase or (Decrease)
	(in millions)		
Net income from:			
CP Rail	**$ 63.5**	$ 54.8	$ 8.7
CP Trucks	**1.5**	C.8	0.7
CP Telecommunications	**3.0**	2.6	0.4
CP Air	**20.0**	3.3	16.7
CP Ships	**(8.0)**	(10.3)	2.3
Miscellaneous	**20.5**	7.5	13.0
CP Investments Limited	**225.6**	170.0	55.6
Equity in income of subsidiary not consolidated	**14.8**	11.1	3.7
Income before extraordinary item	**340.9**	239.8	101.1
Extraordinary item	**—**	7.2	(7.2)
Net income	**$340.9**	$247.0	$ 93.9
Per Ordinary share:			
Income before extraordinary item	**$4.72**	$3.31	$1.41
Net income	**4.72**	3.41	1.31
Dividends	**1.10**	0.95	0.15

CP Rail

Net income from CP Rail of $63.5 million was up $8.7 million, or 16%, over 1977. Revenues rose $142.0 million, or 11%, reflecting a record volume of traffic as well as price increases. Export commodities — coal, potash, sulphur, fertilizers, newsprint — provided most of the volume growth. Further escalation of wage rates and pension costs and of fuel and material prices accounted for most of the increase of $133.3 million, or 11%, in expenses. Extensive programs of track and equipment repairs were also a factor in the rise of expenses.

On the main line between Calgary and Vancouver, construction of a second track progressed at three locations where it is desirable to reduce westbound grades and track curvature. Undertaken at a cost of some $42 million, these projects should facilitate rail operations substantially in an area where traffic is already heavy and growing rapidly.

The first phase of a new domestic containerization program was launched during the year with the placing of orders for more than 300 new containers and loading and carrying equipment. In a related move, a site was acquired in an industrial park on the outskirts of Vancouver, for construction of a new intermodal terminal. This will provide for future growth of traffic in domestic containers, as well as in highway and marine containers. The domestic container system has substantial cost advantages over the present handling of highway trailers on piggyback flat cars.

An updated report by the Commissioner appointed to determine the costs of transporting grain by rail showed that for 1977 CP Rail incurred uncompensated losses in carrying grain exceeding $90 million, even on a variable cost basis.

This latest figure confirms the seriousness of the problem of statutory grain rates. It is encouraging that widespread appreciation is developing of the fact that uneconomically low grain rates are damaging to the interests of Prairie grain growers. However, no concrete action has yet been taken to increase the rates or otherwise make up to the railways their losses from hauling grain, as independently determined.

VIA Rail Canada Inc. took over the Montreal/Toronto to Vancouver passenger service at the end of October, and is expected to take over all other inter-city passenger services during 1979. During the year agreements were reached with VIA on the terms of its purchase of CP Rail passenger equipment, on the transfer to it of certain groups of employees, and on the terms under which CP Rail will provide services for it. Under the new arrangements, CP Rail will no longer be burdened with losses arising from uncompensated variable costs on inter-city passenger services.

CP Trucks

Net income from CP Trucks amounted to $1.5 million, an increase of $763,000 over 1977. This improvement was wholly in the Trucking division, and was attributable to continued stringent control of costs. Increases in wage rates and fuel and material prices absorbed most of the additional revenues produced by higher rates, and volume was about the same as in the previous year. "Excelerater", a premium price, high priority service between Eastern and Western Canada, was successfully introduced during the year.

Results of the Express division were adversely affected by competitive pressures on rates. CanPar, the parcel delivery service, operated by the Express division, continued to expand rapidly and profitably during the year. A new small package service by air, "Expressair", was inaugurated.

Hearings on the application by a U.S. parcel delivery company to obtain operating rights in Canada concluded with a decision against the applicant. However, further hearings are in prospect, during which CP Trucks will continue to oppose the application.

CP Telecommunications

Net income from telecommunications, at $3.0 million, was $377,000 higher than in 1977. The combination of volume growth, notably in telex and leased services, and rate increases produced an additional $10.2 million of revenues. An increase of $9.8 million in expenses was due chiefly to higher costs for wages and benefits, leased facilities and materials.

Hearings were completed during the year on the application of CNCP Telecommunications to the regulatory authority for the right to interconnect with the local switched distribution facilities of Bell Canada. No decision has yet been handed down.

In 1979 CP Telecommunications will commence an upgrading of its transmission facilities and networks and continue the planning for new services designed to capture a larger share of the rapidly growing telecommunications market. Infoswitch, a new switched digital data service introduced in 1978 for commercial use, will be joined up early in 1979 to international networks in the United States and Europe.

CP Air

Net income from CP Air amounted to $20.0 million in 1978, making it the most successful year in the company's history. The increase over 1977 was $16.7 million. Despite the significant strengthening in CP Air's financial position, dividend payments on the ordinary stock were not resumed in order to retain funds for capital expenditures.

Revenues rose $79.7 million, or 20%, over 1977. Increased traffic on most routes and improved passenger yields on every route accounted for the majority of this increase. Traffic benefited from labour disruptions at competing airlines, and yields from the effect of the higher value of foreign currencies in Canadian dollars. Another favourable factor was a $2.1 million net gain on the sale of property in Tokyo.

Expenses, including preference dividends, went up $63.0 million, or 16%, reflecting principally escalation of labour and fuel costs. During 1978 CP Air issued $30 million retractable floating rate preference shares, on which dividends of $874,000 were paid. Continued close monitoring of costs helped to control the rise in expenses. Further revision of flight schedules resulted in a higher daily utilization of aircraft.

CP Air continued to press the Federal Government for a relaxation of the restrictive policies governing the company's domestic operations. An application to consolidate several domestic licenses under one license, thereby allowing greater aircraft routing flexibility, is awaiting approval. CP Air is currently restricted to providing about 27% of the capacity available on the transcontinental route, and is seeking a substantial increase in this percentage, to enable it to serve the cross-Canada market more effectively. An application is being prepared for authority to provide service between Toronto and Halifax.

While no new aircraft were delivered during the year, seven are on order. Three Boeing 737's and three DC-10-30's are to be delivered in 1979. The first two DC-10-30's are to be leased out for a period of one year. An additional DC-10-30 is expected for delivery in 1981. CP Air has also negotiated options for the delivery of four Boeing 737's in 1981 and two DC-10-30's in 1982.

A copy of the financial statements of CP Air for 1978 can be obtained by writing to its Secretary at Vancouver International Airport, Vancouver, B.C. V7B 1V1.

CP Ships

CP Ships, comprising CP (Bermuda), CP Steamships, Limited, and CanPac International Freight Services Limited, had a net loss of $8.0 million in 1978, compared with a loss of $10.3 million in the previous year.

CP (Bermuda)'s loss for the year amounted to $8.2 million, down from the loss of $13.2 million incurred in 1977. The better results reflected exchange gains and income from settlement of charter disputes. In August, after five years of record depressed conditions, the market for tankers and large bulkers improved mainly as a result of increased Middle East oil production, as world inventories were rebuilt. Rates for those two types of vessels more than doubled in the last quarter.

During 1978 CP (Bermuda) took delivery of the last three ships on order. Although no new ships were on order at year end, the fleet is under constant review, and sales and purchases of vessels are made to take advantage of current and prospective shipping conditions.

It is not expected that rates will continue at their year-end levels throughout 1979, nor that they will sink to their previous lows. While the world bulker fleet did not grow in 1978, there is still considerable over-capacity which will take some time to correct, especially if slow rates of economic growth continue.

CP Steamships, Limited had a loss of $486,000, in contrast to a profit of $2.7 million in 1977. Container carryings declined 4% from 1977. This was attributable to increased competition and to major strikes that affected customers in both Canada and the U.K. Competition also seriously depressed rates. Costs continued to rise, due not only to inflation and unfavourable exchange factors, but also to imbalances between westbound and eastbound traffic flows.

Late in 1978 CP Steamships completed the transfer of its container facilities from Quebec City to Montreal. The new location provides better access to its principal markets.

Miscellaneous Income

Most of the increase of $13.0 million in miscellaneous income was attributable to higher interest income and a gain of $4.7 million on the sale of an aircraft.

CP Investments Limited

Net income from CP Investments Limited amounted to a record $225.6 million, compared with $170.0 million, before an extraordinary item of $7.2 million, in 1977.

Summarized Statement of Net Income from CP Investments Limited

	1978	1977	Increase or (Decrease)
	(in millions)		
Oil and gas	**$125.0**	$110.2	$14.8
Mines and minerals	**44.1**	41.1	3.0
Forest products	**18.3**	10.1	8.2
Iron and steel	**46.7**	23.0	23.7
Real estate	**15.3**	11.6	3.7
Hotels and food services	**(15.0)**	(4.7)	(10.3)
Finance	**2.7**	2.5	0.2
Other operations	**7.4**	4.4	3.0
Investment income	**29.4**	6.5	22.9
	273.9	204.7	69.2
Interest of outside CPI shareholders	**48.3**	34.7	13.6
Net income to CP Limited before extraordinary item	**$225.6**	$170.0	$55.6

Oil and Gas

PanCanadian Petroleum Limited had increased earnings due largely to higher prices for oil and gas. Crude oil production was down marginally. Production of natural gas showed an increase early in the year, but subsequent reductions in deliveries taken by gas purchasers as a consequence of a gas surplus resulted in virtually the same production levels as in the previous year. Because of the lack of markets for surplus gas, PanCanadian has increased its exploration in areas considered more promising for oil, notably in the West Pembina area of Alberta. In that area PanCanadian participated in an oil discovery during the year. In the Elmworth region of Alberta, PanCanadian took part in two encouraging oil discoveries, which are currently being evaluated. The company has a 12½% interest in a heavy oil experimental project in the Cold Lake area of Alberta, and purchased a 5% interest in the Syncrude project, which is designed ultimately to produce some 129,000 barrels per day of synthetic crude oil from the Athabasca Tar Sands. These two projects will ensure PanCanadian a substantial participation in long term energy development, and alleviate the effect of declines from presently producing fields. PanCanadian's gas development is continuing in various fields to meet existing contract obligations. Outside Canada, the year's activities included gas discoveries in the Gulf of Mexico and in California, and oil discoveries in Louisiana and Colorado.

Mines and Minerals

Cominco Ltd. had slightly higher earnings in 1978. CPI's 53.9% share of these, after dividends on Cominco's preferred stock and adjustment for charges relating to a prior period, amounted to $30.2 million, down from $31.4 million in 1977. The lower value of the Canadian dollar relative to the U.S. dollar favourably affected earnings from export sales. Demand and prices for zinc began to strengthen in the latter part of the year with the result that sales of zinc metal and concentrates were substantially higher than in 1977. Lead metal prices further strengthened late in the year. Prices of silver and gold were strong throughout the year and in the fourth quarter were at record levels. While increased production and sales of chemicals and fertilizers reflected the first full year of operation of the new ammonia-urea plant east of Calgary, earnings were affected by higher costs for gas. The high rate of taxation in Saskatchewan continued to prevent Cominco's potash operation from earning a profit.

Fording Coal Limited, 60% owned by CP Investments and 40% by Cominco, had earnings of $19.5 million in 1978, compared with $12.3 million in the previous year. In addition to its direct share of this income and its equity in Cominco's share, CPI received ownership payments from Fording which amounted, before tax, to $3.2 million in 1978 and $2.3 million in 1977. The increase in Fording's earnings was the product of higher sales volume, lower unit costs, and a small price increase. Coal sales totalled 2.8 million long tons during the year, compared with 2.3 million tons in 1977.

Forest Products

Great Lakes Forest Products Limited had higher earnings than in 1977, and income of CPI from its 55.7% share amounted to $11.3 million, compared with $8.1 million in 1977. The larger exchange premium on the U.S. dollar and higher shipments for all products mainly accounted for the improved earnings. Negative factors were a decrease from 1977 in the average selling price for kraft pulp, rising costs and an eight-day strike of Great Lakes' electrical workers.

Pacific Logging Company Limited had a successful year in 1978, with earnings of $7.3 million, up from $2.2 million in 1977. This substantial improvement reflected increased lumber production, higher prices for logs and lumber, and a gain of $1.5 million on disposal of an investment.

Iron and Steel
The Algoma Steel Corporation, Limited more than doubled its earnings in 1978. CPI's 54.4% share of these amounted to $36.8 million, compared with $15.8 million in 1977. Higher steel shipments, better operating performance and increased selling prices were major factors in the better results. Income from Dominion Bridge, which contributes significantly to Algoma's earnings, was also higher. Labour disruptions at Algoma's coal mines in West Virginia and at its steelworks in Sault Ste. Marie adversely affected earnings. New three-year collective agreements were concluded in each case. Capital expenditures are being increased significantly in 1979. Projects include expansion of heat treat facilities to increase capacity to produce high strength seamless casing, a new facility for heat treating plate, the new continuous slab casting facility and work on mine development.

In addition to its interest in Algoma's 43.1% share of the income of Dominion Bridge Company, Limited, CPI has a direct shareholding which accounted for $4.6 million of income in 1978. This was $2.3 million more than in 1977, and reflected not only higher earnings of Dominion Bridge, but also purchases during the year of additional shares which raised CPI's direct share to 8.7%, from 6.0% at the end of 1977. By continually broadening and diversifying its earnings base, Dominion Bridge has been developed into a major international corporation serving such growing markets as energy, chemical processing, steel, packaging, construction, bulk materials handling, heavy construction and contracting in North America and overseas.

Operations at Steep Rock Iron Mines Limited continued throughout the year and earnings there were up over 1977, reflecting the higher U.S. dollar exchange premium. CPI's income from Steep Rock, representing a 70.3% share, amounted to $5.4 million, compared with $5.0 million in 1977. Plans are progressing for the termination of operations at Atikokan in 1979. Steep Rock had decided not to proceed with development of an iron ore property at Bending Lake, Ontario, because of a surplus of iron ore in the Great Lakes region. However, it has a three-year extension of its option on the property and will continue to maintain its pellet plant intact so that the project may go ahead when markets improve in the future.

Real Estate
Marathon Realty Company Limited achieved record earnings in 1978, reflecting not only higher returns from its continually expanding portfolio of shopping centres, office buildings and industrial buildings, but also gains on property sales. In June, Marathon disposed of its residential properties in British Columbia, comprising two condominium and two rental apartment complexes. Expansion during the year involved the purchase of two office properties in Edmonton and two in Atlanta, Georgia, the completion of construction of Phase I of an office complex in Burnaby, B.C., and the purchase of three shopping centres — one in each of Toronto, London, Ontario, and Calgary. Projects on which construction was in progress at year end included office buildings in Toronto, San Francisco and Portland, Oregon, a retail complex in Kitchener, Ontario, and a shopping centre near Ottawa. Site work is under way for the new head office of PanCanadian Petroleum in Calgary.

Hotels and Food Services
CP Hotels Limited incurred a loss of $15.0 million for the year, as a result of losses on foreign operations and write-offs relating to development projects undertaken in prior years. Canadian operations were adversely affected by strong competition and markets that were essentially weak. Outside Canada, heavy losses were incurred at the Frankfurt Plaza Hotel in Frankfurt. During the year, construction continued at the Chateau Airport Hotel and the new airline catering facility at the Calgary International Airport. CP Hotels will manage a luxury convention hotel being built in Philadelphia, marking CP Hotels' initial step into the United States.

Finance
Chateau Insurance Company and Canadian Pacific Securities Limited both had slightly higher earnings in 1978. However, the increases were partially offset by the effect of the elimination from the Finance group of income from CanPac Leasing Limited after it was sold in April 1977.

Other Operations
Other Operations provided increased income, through the earnings added by acquisition of Syracuse China Corporation in April 1978 and higher sales volumes of tallow for Baker Commodities, Inc. Both of these U.S.-based companies are now owned by Canellus Incorporated, a wholly-owned U.S. subsidiary of Canellus International N.V., which was incorporated in the Netherlands to hold the non-Canadian interests of CP Investments.

Investment Income
Investment income was up significantly, principally due to the net gain of $23.8 million on the sale of CPI's 12% interest in TransCanada PipeLines Limited.

A copy of the 1978 annual report of Canadian Pacific Investments Limited can be obtained by writing to the Secretary of that company at Suite 1900, Place du Canada, Montreal, Quebec H3B 2N2.

Directorate

Mr. W. A. Arbuckle and Mr. N. E. Whitmore retired as Directors of the Company at the Annual General Meeting of Shareholders held on May 3, 1978. At that meeting the Board of Directors was reduced from 24 to 22 members and, therefore, the vacancies caused by their retirement were not filled. The Directors desire to record their recognition and appreciation of the notable contribution made to the affairs of the Company by Mr. Arbuckle and Mr. Whitmore during the long period of their service on the Board.

Summary of Significant Accounting Policies

General

Basic financial reporting and consolidation policy

Canadian Pacific Limited (CPL) has organized its enterprises into two distinct groups. CPL, directly and through subsidiaries, carries on the transportation enterprises. Canadian Pacific Investments Limited (CPI), in which CPL held 82.37% of the common shares (82.31% of total voting shares) at December 31, 1978 (82.37% and 82.30% respectively at December 31, 1977), is the vehicle through which all other operations are carried on.

The consolidated financial statements include the financial statements of CPL and all subsidiary companies with the exception of those of Soo Line Railroad Company, which operates a railroad in the Northwestern United States and is regulated by the Interstate Commerce Commission. CPL accounts for its investment in this company, which is 56% owned, by the equity method, and its summarized financial information is presented on page 18.

The statement of consolidated income on page 10 is designed to present clearly CPL's income from each of its two major operating groups. Income from transportation is further segregated between the major functions — rail, trucks, telecommunications, air and ships. A similar breakdown of income by function is presented on page 14 for the operations carried on through CPI. The significant accounting policies of each group are described below, and should be read in conjunction with the financial statements, the other financial information and the notes to consolidated financial statements.

Foreign exchange

Items in foreign currencies have been translated into Canadian dollars at current rates, except for properties and related depreciation, investments, long term debt and debenture and capital stocks, for which historical rates have been used. Gains or losses on exchange translation are included in or charged to income.

Pensions

In addition to current service costs, charges to income include annual payments on account of past service liabilities. Such liabilities are being funded over varying periods to 2027.

Income taxes

The companies follow the tax allocation basis of accounting for income taxes, whereby tax provisions are based on accounting income and taxes relating to timing differences between accounting and taxable income are deferred.

Transportation

Income reporting by function

As explained above, CPL operates its various transportation enterprises as separate profit centres. CP Rail, comprising railway and coastal steamship operations, and CP Telecommunications, are departments of CPL. The remaining profit centres CP Trucks (Canadian Pacific Transport Company, Limited), CP Air (Canadian Pacific Air Lines, Limited) and CP Ships (Canadian Pacific Steamships, Limited, Canadian Pacific (Bermuda) Limited and CanPac International Freight Services Limited) are operated through wholly-owned subsidiary companies.

In order to present fairly the results by profit centre, charges for services performed by one profit centre for another, which are made at normal tariff or other arm's length rates, are not eliminated. Consolidated net income is not affected by this practice. Rent for leased railroads and interest on consolidated debenture stock are assigned to CP Rail, while other interest paid by CPL is allocated to CP Rail, CP Telecommunications and Miscellaneous income as appropriate. Interest paid by other transportation companies is charged to their respective profit centres.

CPL's income taxes are allocated to CP Rail, CP Telecommunications and Miscellaneous income on the basis of accounting income as adjusted for non-taxable items. Taxes of other transportation companies are charged to their respective profit centres.

Properties

Maintenance and repairs are charged to expenses as incurred. Major additions and replacements generally are capitalized with the exception of the following which are charged to expenses:

1. Labour costs relating to track material replacements.
2. Renewals of parts of units of railway property which do not constitute "major renewals" as defined by the Uniform Classification of Accounts for Class 1 Common Carriers by Railway of the Canadian Transport Commission.

Depreciation

Depreciation is calculated on the straight-line basis at rates based upon the estimated service lives of depreciable property. For railway properties, the rates used are as authorized by the Canadian Transport Commission; for telecommunications properties, the rates used are as authorized by the Canadian Radio-television and Telecommunications Commission. When depreciable property is retired or otherwise disposed of, the total book value (less net salvage) is charged to accumulated depreciation.

Estimated service lives used for principal categories of assets are as follows:

Road diesel locomotives	20 years
Railway freight cars	30 years
Ships	20 to 25 years
Aircraft	14 to 15 years
Telecommunications equipment	7 to 22 years
Trucks	8 to 12 years

Non-Transportation

Income reporting by function

The non-transportation activities are carried on by CPI through its various subsidiary companies. These, classified by line of business, are as follows:

		Percentage ownership by CPI
Oil and gas	PanCanadian Petroleum Limited	87.10%
Mines and minerals	Cominco Ltd.	53.91%
	Fording Coal Limited	60% CPI and 40% Cominco
Forest products	Pacific Logging Company Limited	100%
	Great Lakes Forest Products Limited*	55.69%
	Commandant Properties, Limited	100%
Iron and steel	The Algoma Steel Corporation, Limited	54.40%
	Steep Rock Iron Mines Limited	70.33%
	Dominion Bridge Company, Limited	8.68% CPI and 43.10% Algoma
Real estate	Marathon Realty Company Limited	100%
Hotels and food services	Canadian Pacific Hotels Limited	100%
Finance	Canadian Pacific Securities Limited	100%
	Chateau Insurance Company	99.96%
Other operations	Canellus International N.V.	100%
	Rothsay Concentrates Co. Limited	100%

*Prior to January 1, 1979, the name of this company was The Great Lakes Paper Company, Limited.

Steep Rock supplies iron ore pellets to Algoma Steel and Algoma supplies structural steel and plate to Dominion Bridge. In reporting the results of Iron and Steel operations in the analysis of CPI's operations on page 14, the following amounts have been eliminated from sales and operating revenue and from expenses: 1978, $63,920,000; 1977, $35,633,000. Inter-company interest charges, amounting to $29,310,000 in 1978 and $29,632,000 in 1977, have not been eliminated in the analysis of CPI's operations in order to present fairly the results by activity. CPI's net income is not affected by these practices. Interest has been eliminated from CPI's revenues and expenses in the CPL Statement of Consolidated Income on page 10. There are no other significant inter-company charges within the CPI group of companies.

Inventories

Raw materials and products of mining operations are valued generally at the lower of cost (determined on the monthly average method) and net realizable value. Stores and materials are valued at cost less appropriate allowances for obsolescence.

Finished products and work in process of Iron and Steel operations are valued at the lower of cost and net realizable value. Work in progress related to construction contracts is stated at accumulated production costs less amounts charged to income based on the percentage of completion of individual contracts. Raw materials and supplies are valued at the lower of cost and replacement cost.

Other inventories (principally related to Forest Products and Other Operations) are valued at the lower of cost (generally average cost) and net realizable value.

Accounting for oil and gas properties

The full cost method of accounting is followed for oil and gas properties, whereby all costs related to the exploration for and the development of oil and gas reserves are capitalized. Such costs are depleted by the unit of production method based on estimated proven oil and gas reserves.

Accounting for mining properties

Expenditures on general mineral exploration are charged against earnings as incurred. Expenditures to investigate identified properties and to develop new mines are capitalized as mineral properties and development. Because of the uncertainty of the final outcome, expenditures on investigation, together with the cost of certain investments in mineral companies, are amortized against earnings by charges for depletion. Abandoned properties are written off in the year of abandonment. Depletion on operating mines is provided on a units of production or on a time basis based on the mineral reserves position.

Accounting for iron and steel properties

Depreciation of manufacturing plant and equipment is provided on the straight-line basis at rates intended to write off these assets over their estimated economic lives. Mining equipment, mine development and deferred overburden removal costs are amortized on a unit of production basis over the estimated recoverable iron ore and coal reserves.

Expenditures on exploration for, investigation of, and holding, raw material properties, and costs of research, development and start-up of new production facilities, are charged to earnings as incurred.

Interest incurred on funds borrowed directly to finance the development of new raw material properties is capitalized during the period of construction and initial development. Such interest is included in the charge to earnings for depreciation and amortization when production commences in commercial quantities.

Accounting for real estate properties

Land is carried at cost. Development costs and carrying costs, net of incidental revenue, are capitalized for land currently being developed or on which development is expected within five years, providing the book value of the land does not exceed market value. Carrying costs of all other land are included in operations.

Buildings and construction in progress are carried at cost, including interest during construction, pre-completion operating costs less any revenue, and other direct development expenses.

The sinking fund method of providing for depreciation is used for major real estate developments. The sinking fund method will write off the cost of the buildings over a maximum period of 40 years in a series of annual instalments increasing at the rate of 5% compounded annually. Under this method depreciation charged to income in later years will be substantially higher than the amount charged in earlier years.

Accounting for other properties

Depreciation and amortization of other properties are charged to earnings, generally on the straight-line basis, over the estimated economic lives of the facilities involved.

Interest on debt incurred to finance major expansion programs under Forest Products and Hotels and Food Services is capitalized during the construction period.

Statement of Consolidated Income

For the Year ended December 31	1978	1977
	(in thousands)	
CP Rail		
Revenues (Page 15)	**$1,428,435**	$1,286,392
Expenses including income taxes	**1,364,945**	1,231,600
Net income	**63,490**	54,792
CP Trucks		
Revenues	**194,642**	186,384
Expenses including income taxes	**193,107**	185,612
Net income	**1,535**	772
CP Telecommunications		
Revenues	**86,416**	76,242
Expenses including income taxes	**83,437**	73,640
Net income	**2,979**	2,602
CP Air		
Revenues	**474,800**	395,068
Expenses including income taxes and preference dividend	**454,802**	391,728
Net income	**19,998**	3,340
CP Ships		
Revenues	**185,582**	143,197
Expenses including income taxes	**193,613**	153,516
Net income	**(8,031)**	(10,319)
Miscellaneous		
Net income	**20,466**	7,522
CP Investments Limited *(Page 14)*		
Revenues	**4,247,373**	2,696,944
Expenses including income taxes	**3,840,244**	2,409,528
	407,129	287,416
Minority interest	**181,511**	117,414
Net income	**225,618**	170,002
Equity in Income of Subsidiary not Consolidated	**14,815**	11,151
Income before Extraordinary Item	**340,870**	239,862
Extraordinary Item *(Page 15)*	**—**	7,166
Net Income	**$ 340,870**	$ 247,028
Earnings per Ordinary Share		
Income before extraordinary item	**$4.72**	$3.31
Net income	**4.72**	3.41

See Summary of Significant Accounting Policies, Other Financial Information and Notes to Consolidated Financial Statements.

Statement of Consolidated Retained Income

For the Year ended December 31	1978	1977
	(in thousands)	
Balance, January 1	**$1,665,679**	$1,497,968
Net income for the year	**340,870**	247,028
	2,006,549	1,744,996
Increase in minority interest arising from conversion of preferred shares of CPI	**—**	8,540
Commission, expense and discount relating to issuance and cancellation of preferred shares by subsidiary companies	**104**	92
Dividends		
7¼ % Preferred shares	**1,887**	2,076
4% Preference stock	**539**	530
Ordinary stock (per share — 1978 - $1.10; 1977 - 95¢)	**78,828**	68,079
Total dividends	**81,254**	70,685
Balance, December 31	**$1,925,191**	$1,665,679

Statement of Changes in Consolidated Financial Position

	For the Year ended December 31	1978	1977
		(in thousands)	
Source of Funds	Income before extraordinary item	**$ 340,870**	$ 239,862
	Add/(Deduct)		
	Depreciation, depletion and amortization	**378,649**	326,157
	Deferred income taxes	**104,698**	50,689
	Equity in net income of companies accounted for by the equity method	**(16,913)**	(29,109)
	Dividends from companies accounted for by the equity method	**10,028**	10,657
	Minority interest in income of subsidiaries	**182,385**	117,414
	Funds from operations	**999,717**	715,670
	Proceeds from sale of subsidiary	**—**	71,359
	Sales of investments	**63,588**	14,269
	Issuance of long term debt	**517,544**	271,169
	Issuance of preference shares by subsidiaries	**80,000**	80,000
	Proceeds from disposal of properties	**73,216**	34,397
	Working capital of subsidiaries acquired and consolidated	**127,093**	4,107
	Working capital deficit of subsidiary sold	**—**	18,520
	Sundries (net)	**2,704**	(7,445)
		$1,863,862	$1,202,046
Application of Funds	Additions to properties	**$ 917,115**	$ 572,641
	Additions to investments	**50,551**	85,819
	Investment in subsidiaries acquired and consolidated	**24,367**	6,983
	Reduction in long term debt	**280,826**	215,147
	Reduction of minority shareholders' interest in subsidiaries	**11,227**	257
	Preferred shares purchased for cancellation	**3,104**	2,082
	Dividends declared	**81,254**	70,685
	Dividends paid minority shareholders of subsidiaries	**61,656**	45,503
	Increase in working capital	**433,762**	202,929
		$1,863,862	$1,202,046

See Summary of Significant Accounting Policies, Other Financial Information and Notes to Consolidated Financial Statements.

Consolidated Balance Sheet — Assets

	December 31	1978	1977
		(in thousands)	
Current Assets	Cash and temporary investments, at cost (approximates market)	$ 819,473	$ 485,322
	Accounts receivable	1,061,769	622,378
	Rail materials and supplies, at cost or less	104,499	102,376
	Other inventories	703,324	514,638
		2,689,065	1,724,714
Insurance Fund, at cost	(approximate market $4,263,000; 1977 — $3,714,000)	4,566	4,075
Investments	Subsidiary company not consolidated	89,404	82,133
	Portfolio, at cost (market value $144,306,000; 1977 — $203,000,000) (Page 16)	152,668	215,333
	Other (Page 16)	284,362	328,041
		526,434	625,507
Properties, at cost (Page 16)	CP Rail	2,911,041	2,836,142
	CP Trucks	122,916	118,735
	CP Telecommunications	177,901	165,895
	CP Air	409,389	399,993
	CP Ships	528,612	506,798
	Miscellaneous	18,733	17,289
	CP Investments Limited	4,677,688	3,899,164
		8,846,280	7,944,016
	Less: Accumulated depreciation, depletion and amortization	3,345,251	3,073,974
		5,501,029	4,870,042
Other Assets and Deferred Charges		214,271	133,081
		$8,935,365	$7,357,419

Auditors' Report to the Shareholders of Canadian Pacific Limited:

We have examined the consolidated balance sheet of Canadian Pacific Limited as at December 31, 1978 and the statements of consolidated income, consolidated retained income and changes in consolidated financial position for the year then ended. For Canadian Pacific Limited and for those other companies of which we are the auditors and which are consolidated in these financial statements, our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. We have relied upon the reports of the auditors who have examined the financial statements of the other consolidated subsidiaries, which include The Algoma Steel Corporation, Limited, Canadian Pacific (Bermuda) Limited, Cominco Ltd., Dominion Bridge Company, Limited, Great Lakes Forest Products Limited, Steep Rock Iron Mines Limited and of Soo Line Railroad Company which is accounted for by the equity method.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Price Waterhouse & Co., Chartered Accountants,
Montreal, Quebec,
March 9, 1979.

Consolidated Balance Sheet — Liabilities

December 31		1978 (in thousands)	1977
Current Liabilities	Bank loans	$ 67,816	$ 63,600
	Accounts payable and accrued liabilities	1,175,420	779,374
	Notes and accrued interest payable	308,079	289,895
	Income and other taxes payable	150,984	94,091
	Dividends payable	50,367	40,948
	Long term debt maturing within one year	237,703	191,872
		1,990,369	1,459,780
Deferred Liabilities		65,405	45,524
Insurance Reserve		4,566	4,075
Long Term Debt (Page 17)		2,102,864	1,751,436
Perpetual 4% Consolidated Debenture Stock (Page 18)		292,549	292,549
Minority Shareholders' Interest in Subsidiary Companies (Page 19)		1,222,662	944,037
Deferred Income Taxes		679,167	558,403
Shareholders' Equity	Preferred shares (Page 19)		
	Authorized — 22,897,099 shares of a par value of $10 each		
	Issued — 2,515,311 7¼ % Cumulative Redeemable Series A shares (1977 — 2,812,670)	25,153	28,127
	Preference stock — 4% non-cumulative		
	Authorized — an amount not exceeding one-half the aggregate amount of Ordinary stock outstanding		
	Issued — £864,923 in amounts of £1 and multiples thereof (1977 — £865,019)	4,209	4,210
	— in amounts of $3 and multiples thereof	11,539	11,539
		15,748	15,749
	Ordinary stock		
	Authorized — 100,000,000 shares of a par value of $5 each		
	Issued — 71,662,280 shares	358,311	358,311
	Premium on stock	113,690	113,819
	Other paid-in surplus	139,690	119,930
	Retained income	1,925,191	1,665,679
		2,577,783	2,301,615
		$8,935,365	$7,357,419

Approved on behalf of the Board:
Ian D. Sinclair, Director
F. S. Burbidge, Director

See Summary of Significant Accounting Policies, Other Financial Information and Notes to Consolidated Financial Statements.

Other Financial Information

CP Investments Limited — Net Income

	1978	1977
	(in thousands)	
Oil and gas		
Gross operating revenue	$ 332,881	$301,346
Expenses including income taxes	189,425	174,800
	143,456	126,546
Interest of outside shareholders	18,506	16,324
Net income	124,950	110,222
Mines and minerals		
Gross operating revenue	1,089,777	917,406
Expenses including income taxes	1,007,907	839,534
	81,870	77,872
Interest of outside shareholders	37,739	36,808
Net income	44,131	41,064
Forest products		
Sales and operating revenue	361,254	305,421
Expenses including income taxes	333,786	289,032
	27,468	16,389
Interest of outside shareholders	9,166	6,252
Net income	18,302	10,137
Iron and steel		
Sales and operating revenue	1,863,793	715,366
Expenses including income taxes	1,749,515	669,212
	114,278	46,154
Interest of outside shareholders	67,557	23,166
Net income	46,721	22,988
Real estate		
Gross rentals and other income	128,690	95,784
Expenses including income taxes	113,164	84,031
	15,526	11,753
Interest of outside shareholders	211	184
Net income	15,315	11,569
Hotels and food services		
Gross operating revenue	182,124	154,785
Expenses including income taxes	197,111	159,481
Net income	(14,987)	(4,696)
Finance		
Gross operating revenue	62,922	61,150
Expenses including income taxes	60,191	58,661
Net income	2,731	2,489
Other operations		
Gross operating revenue	208,290	156,612
Expenses including income taxes	200,857	152,186
Net income	7,433	4,426
Investment income		
Gross income	46,952	18,706
Expenses including income taxes	17,598	12,223
Net income	29,354	6,483
Income before interest of outside CPI shareholders	273,950	204,682
Interest of outside CPI shareholders	48,332	34,680
Net income before extraordinary item	$ 225,618	$170,002

Other Financial Information

Rail Revenues

	1978	1977
	(in thousands)	
Freight revenue	**$1,235,376**	$1,112,099
Passenger services	**28,873**	21,541
Other railway	**41,097**	35,878
Coastal steamships	**22,109**	14,763
Government payments	**100,980**	102,111
	$1,428,435	$1,286,392

Income Taxes

	1978	1977
	(in thousands)	
Charged to income before equity in income of subsidiary —		
Current	**$ 205,823**	$ 156,318
Deferred	**104,698**	50,689
	$ 310,521	$ 207,007

Interest Expense

	1978	1977
	(in thousands)	
Long term debt and debenture stock	**$ 203,721**	$ 171,964
Short term debt	**32,492**	32,637
	$ 236,213	$ 204,601

Interest capitalized on funds borrowed to finance capital projects amounted to $8,589,000 (1977 — $8,928,000).

Extraordinary Item

	1978	1977
	(in thousands)	
Net gain on sale of CanPac Leasing Limited after income taxes of $2,051,000	**$ —**	$ 6,491
Reduction in income taxes from application of loss carry-forward	**—**	2,051
	—	8,542
Minority interest	**—**	1,376
	$ —	$ 7,166

Depreciation, Depletion and Amortization Charged to Expenses

	1978	1977
	(in thousands)	
CP Rail	**$ 80,176**	$ 78,145
CP Trucks	**6,818**	6,422
CP Telecommunications	**10,043**	9,712
CP Air	**24,760**	29,151
CP Ships	**23,268**	21,104
Miscellaneous	**513**	529
CP Investments Limited		
Oil and gas	**40,749**	33,910
Mines and minerals	**76,268**	71,584
Forest products	**25,641**	24,827
Iron and steel	**67,526**	35,664
Real estate	**5,555**	4,758
Hotels and food services	**13,954**	8,369
Other operations	**3,378**	1,982
	$ 378,649	$ 326,157

Other Financial Information

Investment Portfolio as at December 31, 1978

	Number of shares	Percentage of outstanding voting shares	Cost	Approximate market value
			(in thousands)	
Common Stocks				
MacMillan Bloedel Limited	2,849,600	13.40	$ 82,560	$ 62,349
MICC Investments Limited	323,900	5.66	1,484	3,239
Norcen Energy Resources Limited	271,700	1.19	3,804	4,891
Rio Algom Limited	1,331,956	9.86	30,823	45,952
Union Carbide Canada Limited	825,300	8.25	18,375	14,344
Other			5,726	5,129
			142,772	135,904
Preferred Stocks			7,588	6,310
Bonds, Debentures and Notes			2,308	2,092
			$152,668	$144,306

Other Investments

	1978	1977
	(in thousands)	
Dominion Bridge Company, Limited, at cost plus equity in undistributed net income (now consolidated)	**$ —**	$ 95,972
Others, at cost:		
Tara Exploration and Development Company Limited	**26,903**	26,903
Bethlehem Copper Corporation	**41,313**	41,310
Panarctic Oils Ltd.	**39,119**	36,932
Tilden Iron Ore Company	**34,458**	25,331
Northern Alberta Railways Company	**25,340**	25,340
The Toronto Terminals Railway Company	**9,182**	9,182
Other	**108,047**	67,071
	$284,362	$328,041

Properties and Accumulated Depreciation, Depletion and Amortization

	1978			1977
	(in thousands)			
	Cost	Accumulated Depreciation, Depletion and Amortization	Net	Net
CP Rail*	$2,911,041	$1,363,163	$1,547,878	$1,475,170
CP Trucks	122,916	50,953	71,963	68,286
CP Telecommunications	177,901	85,896	92,005	87,842
CP Air	409,389	201,180	208,209	213,601
CP Ships	528,612	95,143	433,469	430,778
Miscellaneous	18,733	1,972	16,761	15,757
CP Investments Limited				
Oil and gas	1,047,391	242,146	805,245	505,896
Mines and minerals	1,122,659	445,035	677,624	668,986
Forest products	526,345	204,356	321,989	327,773
Iron and steel	1,232,901	568,151	664,750	541,875
Real estate	512,023	28,857	483,166	390,764
Hotels and food services	195,910	51,721	144,189	128,369
Other operations	40,459	6,678	33,781	14,945
Total CP Investments	4,677,688	1,546,944	3,130,744	2,578,608
	$8,846,280	$3,345,251	$5,501,029	$4,870,042

*Includes $42,351,000 (1977 — $43,291,000) securities of leased railway companies.

Other Financial Information

Long Term Debt

	1978	1977
	(in thousands)	
Canadian Pacific Limited		
Collateral Trust Bonds		
Twenty-five year 5%, due 1983	**$ 31,536**	$ 31,536
Seven year 8⅛%, due 1985	**27,750**	—
Twenty year 8½%, due 1989	**5,868**	6,170
Twenty-one year 8⅞%, due 1992	**45,546**	48,460
Twenty year 10.35%, due 1994	**74,250**	74,250
Twenty year 11¼%, due 1995	**60,000**	60,000
Equipment Trust Certificates		
5% - 10⅛%, due 1980-1993	**120,661**	129,694
Bank loans and sundry borrowings, due 1979-1985	**159,710**	164,355
Canadian Pacific (Bermuda) Limited		
Mortgages, due 1979-1986	**74,023**	61,400
Notes, 8¼%, due 1984	**37,807**	42,481
Bank loan, due 1985	**20,720**	—
Canadian Pacific Steamships, Limited		
Bank loan, due 1979	**1,735**	4,089
Canadian Pacific Transport Company, Limited		
Bank loan	**6,750**	6,750
Canadian Pacific Investments Limited		
Income debentures, 4¾% - 7½%, due 1979-1980	**67,350**	74,200
Bank loan, due 1978	**—**	5,000
The Algoma Steel Corporation, Limited		
Sinking fund debentures, 5¼%, due 1978	**—**	10,000
Sinking fund debentures, 7⅜%, due 1987	**21,600**	22,800
Sinking fund debentures, 8¾%, due 1991	**31,400**	32,605
Sinking fund debentures, 10⅜%, due 1994	**50,000**	50,000
Sinking fund debentures, 11%, due 1995	**65,000**	65,000
Notes, 8½%, due 1991	**21,000**	21,500
Short term — convertible into term loans to 1979	**26,130**	36,722
Other	**15,125**	15,743
Canadian Pacific Hotels Limited		
First mortgage sinking fund bonds, 8⅝%, due 1992	**19,000**	19,500
First mortgage sinking fund bonds, 11⅜%, due 1995	**30,000**	30,000
Sundry — due 1979-1988	**13,326**	10,311
Canadian Pacific Securities Limited		
Sinking fund debentures, 9½%, due 1990	**22,000**	22,750
Sinking fund debentures, 9⅜%, due 1990	**36,400**	37,122
Sinking fund debentures, 8¼%, due 1993	**15,000**	15,000
Notes, 9¼% - 10⅛%, due 1980-1983	**75,000**	75,000
Debentures, 10½%, due 1984	**30,000**	30,000
Bank loan, 7%, due 1979	**25,000**	25,000
Bank loan, due 1985	**3,210**	3,210
Cominco Ltd.		
Sinking fund debentures, 8½%, due 1991	**58,952**	61,740
Sinking fund debentures, 10⅞%, due 1995	**60,000**	60,000
Bank loans, due 1979-1985	**35,162**	36,545
Notes, due 1982-1996	**49,224**	49,224
Subsidiaries of Cominco Ltd.	**50,364**	55,328
Dominion Bridge Company, Limited		
Sinking fund debentures, 6½%, due 1986	**7,489**	—
Debentures, 9%, due 1986	**28,081**	—
Bank loans, due 1979-1987	**73,154**	—
Other notes payable, due 1979-1996	**51,955**	—
Fording Coal Limited — bank loans, due 1978	**—**	15,000
Great Lakes Forest Products Limited		
Sinking fund bonds, 8%, due 1989	**15,726**	16,430
Sinking fund bonds, 11¼%, due 1995	**34,420**	35,000
Debentures, 8¾%, due 1984	**20,966**	20,966
Floating rate income debentures, due 1980	**35,580**	31,704
Carried forward	**$1,753,970**	$1,612,585

Other Financial Information

Long Term Debt (continued)

	1978	1977
	(in thousands)	
Brought forward	$1,753,970	$1,612,585
Marathon Realty Company Limited		
Sinking fund mortgage bonds, 10%, due 1998	55,000	—
Sundry loans and mortgages payable 1979-2006	165,851	145,686
Bank loans, due 1979-1983	49,051	22,185
PanCanadian Petroleum Limited		
Bank loans, due 1979-1988	195,883	45,447
Sinking fund secured debentures, 8⅛%, due 1992	23,500	24,250
Sinking fund secured debentures, 8¾%, due 1992	24,500	25,000
Sinking fund debentures, 9¾%, due 1983	35,000	35,000
Steep Rock Iron Mines Limited		
Sundry — due 1979	7,656	9,745
Other companies	30,156	23,410
	2,340,567	1,943,308
Less: Long term debt maturing within one year	237,703	191,872
	$2,102,864	$1,751,436

Collateral Trust Bonds of Canadian Pacific Limited are secured by pledge of Perpetual 4% Consolidated Debenture Stock aggregating in principal amount $521,921,000 at December 31, 1978 (1977 — $484,603,000).

Of the aggregate bank loans of $658,463,000 included above, approximately $497,166,000 bear interest at rates which fluctuate (in certain cases within defined limits) with the lender's prime commercial rate.

Foreign currency long term debt translated at current rates at December 31, 1978 would be $1,013,434,000, which is $120,007,000 more than the amount at which it is carried above.

Annual maturities and sinking fund requirements for each of the five years following 1978 are: 1979 — $237,703,000; 1980 — $164,675,000; 1981 — $222,938,000; 1982 — $173,440,000; 1983 — $283,053,000.

Perpetual 4% Consolidated Debenture Stock

	Sterling	United States Currency	Canadian Currency	Total
	(in thousands)			
Issued	£46,757	$296,250	$290,671	$814,470
Less: Pledged as collateral	—	231,250	290,671	521,921
	£46,757	$ 65,000	$ —	$292,549

Sterling translated at Can. $4.86⅔ to the £1; U.S. dollars on the basis of one Canadian dollar equals one U.S. dollar. At December 31, 1978, translated at current rates, the net amount outstanding would be $190,033,000.

Summarized Financial Information of Soo Line Railroad Company (U.S. Currency)

	1978	1977
	(in thousands)	
Income Statement		
Operating revenues	$251,279	$217,251
Railway operating income	$ 38,080	$ 31,367
Interest income	4,249	2,656
Other income — net	1,864	2,530
Fixed charges and contingent interest	(8,470)	(7,551)
Provision for income taxes	(12,400)	(10,200)
Net income	$ 23,323	$ 18,802
Canadian Pacific Limited equity in net income (Canadian currency)	$ 14,815	$ 11,151
Condensed Balance Sheet		
Current assets	$113,135	$ 98,244
Investments and special funds	3,473	2,773
Net properties	294,370	276,053
Other assets and deferred charges	1,517	1,361
	$412,495	$378,431
Current liabilities	$ 67,372	$ 56,527
Long term debt	117,428	109,197
Deferred income taxes	45,800	42,100
Other liabilities and deferred credits	2,165	2,553
Shareholders' equity	179,730	168,054
	$412,495	$378,431

Notes to Consolidated Financial Statements

1. Preferred Shares

The series A preferred shares are redeemable at the Company's option at $10.50 per share on or before January 1, 1981; at $10.25 thereafter and on or before January 1, 1984; and $10.00 thereafter. In addition, shares may be purchased for cancellation at any time subject to certain price restrictions.

The Company is obligated to apply up to $2,000,000 in each year to the purchase of series A preferred shares, if available at a price not exceeding $10.50 per share plus costs of purchase. The price decreases to $10.25 after January 1, 1981 and $10.00 after January 1, 1984.

In 1978, 297,375 shares were purchased for $3,104,000; in 1977, 209,375 shares were purchased for $2,082,000.

2. Minority Shareholders' Interest in Subsidiary Companies

The minority shareholders' interest in subsidiary companies is comprised as follows:

	1978	1977
	(in thousands)	
PanCanadian Petroleum Limited	**$ 56,523**	$ 42,603
Cominco Ltd.		
$2.00 tax deferred exchangeable preferred shares, series A	**50,000**	50,000
Floating rate preferred shares, series C	**50,000**	—
Common share equity	**249,952**	248,976
Great Lakes Forest Products Limited	**43,258**	34,977
The Algoma Steel Corporation, Limited		
8% tax deferred preference shares, series A	**60,000**	60,000
Floating rate preference shares	**80,000**	80,000
Common share equity	**222,381**	203,903
Dominion Bridge Company, Limited	**114,656**	—
Steep Rock Iron Mines Limited	**13,520**	12,324
Canadian Pacific Investments Limited		
4¾% convertible preferred shares, series A	**793**	934
Common share equity	**249,206**	209,389
Canadian Pacific Air Lines, Limited		
Floating rate preference shares, series A	**30,000**	—
Other	**2,373**	931
	$1,222,662	$944,037

The CPI preferred shares, series A, are redeemable at CPI's option at $20 per share.

3. Pensions

At December 31, 1978, there were unfunded liabilities, determined by actuarial evaluations, of $658,000,000 which is being funded by series of equal annual payments ending from 1980 to 1996, and $238,000,000 which is being funded by equal annual payments to 2027.

Pension expense, including current service costs and payments on account of unfunded liabilities, was $156,000,000 in 1978 (1977 — $129,000,000).

4. Commitments

The Company and its subsidiaries had placed orders or were otherwise committed to capital expenditures in the amount of $663,000,000.

Commitments for rent for freight cars and locomotives amount to $94,000,000 and other long term leases amount to $594,000,000.

Algoma Steel, as a participant in an iron ore mining joint venture, is entitled to receive its proportionate share of production and is committed to pay its share of costs including minimum charges for principal and interest to cover the servicing of long term debt. Algoma's share of such minimum charges was $13,000,000 in 1978 and will average approximately $21,000,000 annually during the next five years.

5. Contingencies

The Company is a defendant in two suits by certain minority shareholders of Ontario and Quebec Railway Company, the railway of which the Company operates under a perpetual lease, claiming alleged misuse of the assets and also entitlement to the proceeds from the sale of Ontario and Quebec Railway Company's surplus lands and, in the alternative, substantial damages. The trial of these actions was concluded in December 1977 and the plaintiffs' actions succeeded in part. The Company has appealed the judgment but is of the opinion that even if upheld on appeal, the judgment will not have a materially adverse effect on the financial condition of the Company. Appeals by the plaintiffs are also anticipated.

Final negotiations are being carried out for the sale of the majority of PanCanadian Petroleum's investment in an ammonia plant project. If negotiations are successfully concluded, the sale will be consummated in March and should result in the recovery of PanCanadian's net investment in the project.

Notes to Consolidated Financial Statements

6. Acquisitions

In January 1978, CPI acquired additional shares of Dominion Bridge Company, Limited giving it a direct holding of 6.91%. This, together with Algoma Steel's holding of 43.22% brought the total holding to 50.13%. Dominion Bridge is a diversified engineering and manufacturing company. At the end of April 1978, CPI through subsidiaries acquired all the outstanding shares of Syracuse China Corporation, which manufactures chinaware, through a cash merger. These acquisitions were accounted for as purchases and consolidated from the dates of acquisition.

A summary of the assets acquired and the consideration given is as follows:

	Dominion Bridge	Syracuse China
	(in thousands)	
Net assets of acquired company, other than goodwill, at book value	$128,922	$10,703
Adjustment of net assets acquired, other than goodwill, to fair value	1,162	8,566
Goodwill on books of acquired company arising from an acquisition in 1977	64,813	—
	194,897	19,269
Minority interest	96,616	—
	98,281	19,269
Excess of purchase price over CPI proportion of fair value of assets acquired, ascribed to goodwill	—	2,789
	$ 98,281	$22,058
Consideration given:		
CPI's investment as at December 31, 1977	$ 13,595	$ —
Algoma Steel's investment as at December 31, 1977	82,377	—
Acquired for cash in 1978	2,309	22,058
	$ 98,281	$22,058

7. Restatement

Certain figures for 1977 have been reclassified to conform with the presentation adopted for 1978.

8. Subsequent Events

Marathon Realty Company Limited has arranged to issue $50,000,000 income debentures due 1991, subject to a favourable tax ruling. The proceeds will be used for general corporate purposes.

On February 15, 1979 The Algoma Steel Corporation, Limited sold $60,000,000 income debentures and Algoma is committed to issue a further $40,000,000 subject to a satisfactory tax ruling. The proceeds will be used to redeem short term debt, long term debt and to finance capital expenditures.

Five-Year Summary

	1974	1975	1976	1977	**1978**
	(in thousands)				
Net income from:					
CP Rail	$ 44,573	$ 31,691	$ 51,097	$ 54,792	**$ 63,490**
CP Trucks	(104)	2,877	1,822	772	**1,535**
CP Telecommunications	726	1,442	2,010	2,602	**2,979**
CP Air	2,441	(6,398)	(9,802)	3,340	**19,998**
CP Ships	18,624	14,571	3,598	(10,319)	**(8,031)**
Miscellaneous	1,827	4,200	15,055	7,522	**20,466**
CP Investments Limited	114,233	120,925	117,801	170,002	**225,618**
Equity in income of subsidiary not consolidated	7,785	5,897	8,889	11,151	**14,815**
Income before extraordinary items	190,105	175,205	190,470	239,862	**340,870**
Extraordinary items	4,253	—	—	7,166	**—**
Net Income	$194,358	$175,205	$190,470	$247,028	**$340,870**
Per Ordinary share					
Income before extraordinary items	$2.61	$2.40	$2.62	$3.31	**$4.72**
Net income	2.67	2.40	2.62	3.41	**4.72**
Dividends	$0.86	$0.845	$0.86	$0.95	**$1.10**
Market price — High	$17¾	$17⅛	$18⅞	$19¾	**$25⅝**
(Toronto Stock Exchange) — Low	10½	12⅝	13¼	16	**16⅜**
Price/earnings ratio — High	7	7	7	6	**5**
— Low	4	5	5	5	**3**

Geographic Distribution of Net Property Investment

at December 31, 1978

	Properties at Cost, less Depreciation (millions)	Percent of Total
Canada		
Atlantic Provinces	$ 35	1%
Quebec	367	7
Ontario	1,290	23
Manitoba	146	3
Saskatchewan	243	4
Alberta	984	18
British Columbia	717	13
N.W.T., Yukon & Offshore	113	2
Transportation Equipment	735	13
	4,630	84
Outside Canada		
United States	366	7
Other	100	2
Ocean Ships	405	7
	871	16
Total	$5,501	100%

Canadian Pacific Limited

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